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STATE OF MINNESOTA

OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA PUBLIC UTILITIES COMMISSION

In the Matter of the Proposed Amendments to Rules Governing the Regulatory Treatment of Competitive Local Exchange Carriers (CLECs), Minn. Rules Chs. 7811 and 7812.

REPORT OF THE ADMINISTRATIVE LAW JUDGE

The above-entitled matter came on for hearing in St. Paul before Administrative Law Judge Allan W. Klein on October 5 and again on October 16, 2000. Each hearing session continued until all interested persons, groups and associations had an opportunity to be heard concerning the proposed rules.

This Report is part of a rulemaking proceeding held pursuant to Minn. Stat. §§ 14.31 to 14.20 (2000). The purpose of the proceeding is to hear public comment, to determine whether the Minnesota Public Utilities Commission (hereinafter "the Commission") has fulfilled all relevant substantive and procedural requirements of law applicable to the adoption of rules, whether the proposed rules are needed and reasonable, and whether or not modifications to the rules proposed by the Commission after initial publication are impermissible, substantial changes.

Karen Hammel, Assistant Attorney General, 445 Minnesota Street, 900 NCL Tower, St. Paul, Minnesota 55101, appeared on behalf of the Commission. Eric Witte and Marc Fournier presented the Commission Staff's position and answered questions at each of the hearings.

The record remained open for the submission of written comments until November 3, 2000. During the initial comment period, the ALJ received several written comments from interested persons and the Commission. Pursuant to Minn. Stat. § 14.15, subd. 1, five working days were then allowed for the filing of responsive comments. During this responsive comment period, the Commission met and considered the views of interested persons and made some changes to the proposed rules. Then, the interested persons filed responsive comments with the Administrative Law Judge, as did the Commission. The record closed for all purposes on November 13, 2000.

NOTICE

The Commission must wait at least five working days before taking any final action on the rules; during that period, this Report must be made available to all interested persons upon request.

Pursuant to the provisions of Minn. Stat. § 14.15, subd. 3 and 4, this Report has been submitted to the Chief Administrative Law Judge for his approval. If the Chief Administrative Law Judge approves the adverse findings of this Report, he will advise the Commission of actions which will correct the defects and the Commission may not adopt the rule until the Chief Administrative Law Judge determines that the defects have been corrected. However, in those instances where the Chief Administrative Law Judge identifies defects which relate to the issues of need or reasonableness, the Commission may either adopt the Chief Administrative Law Judge's suggested actions to cure the defects or, in the alternative, if the Commission does not elect to adopt the suggested actions, it must submit the proposed rule to the Legislative Coordinating Commission for the Commission's advice and comment.

If the Commission elects to adopt the actions suggested by the Chief Administrative Law Judge and makes no other changes and the Chief Administrative Law Judge determines that the defects have been corrected, then the Commission may proceed to adopt the rule and submit it to the Revisor of Statutes for a review of the form. If the Commission makes changes in the rule other than those suggested by the Administrative Law Judge and the Chief Administrative Law Judge, then it shall submit the rule, with the complete record, to the Chief Administrative Law Judge for a review of the changes before adopting it and submitting it to the Revisor of Statutes.

When the Commission files the rule with the Secretary of State, it shall give notice on the day of filing to all persons who requested that they be informed of the filing.

Based upon all the testimony, exhibits and written comments, the Administrative Law Judge makes the following:

FINDINGS OF FACT

Procedural Requirements

1. On July 27, 1998, the Commission published a request for comments concerning these rules at 23 State Register 272. Ex. A.

2. On November 16, 1998, the CLEC Advisory Committee held its first meeting. The Committee met several times, and devoted many hours to reviewing a number of drafts of the rules. Committee activities continued throughout 1999 and into the spring and summer of 2000.

3. On July 26, 2000, the Revisor of Statutes certified a copy of the proposed rule amendments. Ex. 104C.

4. On July 31, 2000, the Commission filed a copy of a proposed Notice of Hearing, a copy of the proposed rules, and a draft of the Statement of Need and Reasonableness with the Office of Administrative Hearings. On that same date, the Commission requested prior approval of the additional notice plan described on pages 27 and 28 of the Statement of Need and Reasonableness.

5. On August 7, 2000, the Commission was given approval for its additional notice plan. Ex. 104H1.

6. On August 8, 2000, Burl Haar, the the Commission's Executive Director, executed a Dual Notice of Intent to Adopt Rules, setting a hearing date of October 5, 2000 if 25 or more persons requested a hearing. Ex. 93.

7. On August 8, 2000, Executive Director Haar executed the Commission's Statement of Need and Reasonableness.

8. On August 8, 2000, the Commission filed a copy of the Statement of Need and Reasonableness with the Legislative Reference Library Ex. 104E.

9. On August 17, 2000, the Commission mailed a copy of the Notice of Hearing and the proposed rules to all persons on its statutory rulemaking list, and to all persons who submitted comments in response to the request for comments. In addition, on that date the Commission also mailed to ten state legislators involved in legislation affecting the Commission's rulemaking authority and special legislation authorizing these rules. Ex. 104K1-K13.

10. On August 21, 2000, the Commission published the Notice of Hearing in the State Register at 25 State Register 546. Ex. 104F.

11. More than 25 persons did request a hearing, and so on September 21, 2000, the Commission notified those who had requested a hearing that a hearing would be held on October 5 as previously announced. Ex. 102. At the request of an interested person who could not attend the October 5 hearing, an additional hearing date (October 16) was scheduled and announced.

12. On November 3, the Commission filed comments in response to the testimony and written materials which had been supplied by the public and by other agencies during the hearing process. On November 8, the Commission held a hearing to discuss issues raised during the hearing process. This Commission hearing was scheduled in advance of the October 5 and 16 public hearings, and was announced at those hearings, as well as in the Commission's *Weekly Calendar*. In response to comments, the Commission proposed a number of modifications to its original proposals.

13. On November 13, 1999, the Commission filed a responsive comment, which contained the modifications adopted at the November 8 meeting. The record closed for all purposes on November 13.

All of the above documents have been available for inspection at the Office of Administrative Hearings from the date of filing.

Standards of Review

14. In a rulemaking proceeding, an administrative law judge must determine whether the agency has established the need for and reasonableness of the proposed rule by an affirmative presentation of facts.[1] An agency need not always support a rule with adjudicative or trial-type facts. It may rely on what are called “legislative facts” — that is, general facts concerning questions of common sense, policy, and discretion. The agency may also rely on interpretations of statutes and on stated policy preferences.[2] Here, the Commission prepared a SONAR setting out a number of facts, statutory interpretations, and policy preferences to support the proposed rules. It also supplemented information in the SONAR with information presented both at the hearing and in the written comments and responses placed in the record after the hearing.

15. Inquiry into whether a rule is reasonable focuses on whether the rulemaking record establishes that it has a rational basis, as opposed to being arbitrary. Minnesota law equates an unreasonable rule with an arbitrary rule.[3] Agency action is arbitrary or unreasonable when it takes place without considering surrounding facts and circumstances or disregards them.[4] On the other hand, a rule is generally considered reasonable if it is rationally related to the end that the governing statute seeks to achieve.[5]

16. The Minnesota Supreme Court has defined an agency's burden in adopting rules as having to "explain on what evidence it is relying and how the evidence connects rationally with the agency's choice of action to be taken."[6] An agency is entitled to make choices between different approaches as long as its choice is rational. Generally, it is not proper for an administrative law judge to determine which policy alternative he thinks would be the "best" approach, since making a judgment like that invades the policy-making discretion of the agency. Rather, the question for an administrative law judge is whether the agency’s choice is one that a rational person could have made.[7]

17. In addition to ascertaining whether proposed rules are necessary and reasonable, an administrative law judge must make other decisions — namely, whether the agency complied with the rule adoption procedure; whether the rule grants undue discretion to the agency; whether the agency has statutory authority to adopt the rule; whether the rule is unconstitutional or illegal; whether the rule constitutes an undue delegation of authority to another; and whether the proposed language is not a rule.[8]

18. When an agency makes changes to proposed rules after it publishes them in the *State Register*, an administrative law judge must determine if the new language is substantially different from what the agency originally proposed.[9] The legislature has established standards for determining if the new language is substantially different.[10]

Statutory Authority

19. The Commission cites its general rulemaking authority in Minn. Stat. Sec. 216A.05 and 237.10 (2000). The first of those provides, in pertinent part, as follows:

> It [the Commission] may … prescribe such rules and issue such orders with respect to the control and conduct of the businesses coming within its jurisdiction as the legislature itself might make but only as it shall from time to time authorize.

20. The Commission then cites to Minnesota Statutes § 237.16, subd. 8(a), which provides, in part, as follows:

> [T]he commission shall adopt rules applicable to all telephone companies and telecommunications carriers required to obtain or having obtained a certificate for provision of telephone service using any existing federal standards as minimum standards and incorporating any additional standards or requirements necessary to ensure the provision of high quality telephone services throughout the state. The rules must, at a minimum:
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> (6) prescribe appropriate regulatory standards for new local telephone service providers, that facilitate and support the development of competitive services;
> (7) protect against cross-subsidization, unfair competition, and other practices harmful to promoting fair and reasonable competition;
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> * * *
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> (10) provide for the continued provision of local emergency telephone services under chapter 403; and
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> (11) protect residential and commercial customers from unauthorized changes in service providers in a competitively neutral manner.

Cost and Alternative Assessments in SONAR

21. Minn. Stat. § 14.131 provides that state agencies proposing rules must identify classes of persons affected by the rule, including those incurring costs and those reaping benefits; the probable effect upon state agencies and state revenues; whether less costly or intrusive means exist for achieving the rule's goals; what alternatives were considered and the reasons why any such alternatives were not chosen; the cost that will be incurred complying with the rule; and differences between the proposed rules and existing federal regulations.

22. In the SONAR, the Commission addressed each of these requirements.[11] The Administrative Law Judge finds that the Commission has complied with the requirements of the statute.

Performance-Based Regulation

23. Minn. Stat. § 14.002 directs all agencies, whenever feasible, to develop rules that emphasize superior achievement in meeting the agencies' regulatory objectives and a maximum flexibility for the regulated public in meeting

those goals. It also requires agencies to describe in the SONAR how they considered this policy. The Commission stated in its SONAR that it did take the policy into account when it put greater emphasis on the complaint process, rather than on prior Commission scrutiny of CLEC conduct. The Administrative Law Judge concludes that the Commission has satisfied its burden under Minn. Stat. Sec. 14.002.

History of the Proposed Rule

24. These rules are but a small part of an ongoing evolution of Minnesota's regulatory environment for telecommunications services. One of the principal features of the present environment is competition between incumbent local exchange carriers (ILECs) and new entrants, known as competitive local exchange carriers (CLECs). In the mid-1990s, both state and federal statutory schemes were changed to promote more competition, and as a result of those statutory changes, rules had to change as well.

25. In 1997, the Commission considered two sets of rules in response to the statutory changes. In July of 1997, the Commission adopted Minn. Rule pt. 7812.0050 to 7812.2200. These rules essentially governed areas served by telephone companies with 50,000 or more subscribers. Then in May of 1998, the Commission adopted rules for areas served by local telephone companies with fewer than 50,000 subscribers. While the two sets of rules did differ, they both provided that local services provided by a competitive local exchange carrier (a CLEC) were subject to Minnesota Statutes, chapter 237 and the Commission's rules in the same manner as local services provided by a local exchange carrier (a LEC) except that CLECs were not subject to certain specified statutes and rules. Minn. Rule pt. 7811.2200 and 7812.2200. Those exceptions generally related to rate of return regulation and the filing of cost studies and tariffs. A number of CLECS were dissatisfied with the limited scope of the exemptions provided by these rules, believing that they were still subject to too many regulations. They urged the Commission to go further, and, in 1998, the Commission began this proceeding to further reduce the amount of regulation for CLECs.

Rule-by-Rule Analysis

26. Most of the proposed rules drew no adverse comment. As noted earlier, the Commission did convene an advisory committee, and many of the problems that might have come up in this proceeding appear to have been resolved in the Committee process. This Report is generally limited to the discussion of the portions of the proposed rules that received significant critical comment, or otherwise need to be examined. Accordingly, this Report will not discuss each proposed rule. Persons or groups who do not find their particular comments referenced in this Report should know that each and every submission has been read and considered. The Administrative Law Judge specifically finds that the Commission has demonstrated the need for and reasonableness of provisions of the rules that are not discussed in this Report, that such provisions are within the Commission's statutory authority noted above,

and that there are no other problems that prevent their adoption. Where changes were made to the rule after publication in the State Register, the Administrative Law Judge must determine if the new language is substantially different from that which was proposed originally. Unless specifically mentioned below, the language proposed by the Commission which differs from the rule as published in the State Register is found not to be substantially different.

7811/7812.0700, subp. 5 – Two-day Notice

27. Proposed Rule pts. 7811.0700, subp. 5 and 7812.0700, subp. 5 would have required that a LEC providing wholesale services to a CLEC had to notify the CLEC at least two days before implementing a change in service providers to an end-user customer of the CLEC. This was intended to prevent customers from continuing to be billed by CLECs after they had transferred their service to a different provider, but had failed to notify the first CLEC. Quest urged that this provision be withdrawn because the Commission had failed to demonstrate that it was needed, because it created a substantial administrative burden, and because it was anti-competitive.[12] After the initial hearing, the Coalition[13] conceded that the proposed rule might create practical difficulties and uncertainties which had not been initially appreciated, and that changes in federal requirements had undermined the initial justification for the rule. For those reasons, the Coalition supported Quest's request to delete the subpart.[14]

28. On November 8, 2000, the Commission met to consider questions raised in connection with all of these proposed rules. During that meeting, the Commission voted to withdraw the proposed rule. The Administrative Law Judge concludes that there is no legal reason to prevent the Commission from withdrawing the proposed rule.

7811/7812.2210, subp. 1(A) – Scope of Rules

29. Proposed Rule 7811.2210 (as well as 7812.2210) would replace existing rules 7811.2200 and 7812.2200, which are both proposed for repeal. The two existing rules were first adopted back in 1997 and 1998, and were the ones that some CLECs argued did not go far enough in eliminating regulatory hurdles to competition. As noted earlier, the two existing rules provided that all of the provisions of Chapter 237 would apply to CLECs except as specifically excluded by other statutes or by those rules. Now, the Commission has taken a dramatically different approach with these proposed substitutes. These substitutes provide that the Commission will exercise its regulatory authority only to the extent provided for by these rules. Although not explicitly stated, implicit in that statement is the idea that all other possible regulatory authority which the Commission might exercise (such as other provisions of Chapter 237) will not be exercised. This raises the fundamental question of the Commission's authority to adopt a rule which states that it will not enforce statutes which would otherwise apply to a class of regulated entities.

30. The two rules in question contain the same language. They provide as follows:

> The Commission shall exercise its regulatory authority over the local services provided by CLECs only to the extent provided for in, or necessary to implement the requirements of, this chapter.

31. In the SONAR, the Commission argued that this provision was reasonable for two reasons. First, non-dominant carriers such as CLECs should be allowed less intrusive, more flexible regulatory oversight because in a competitive environment, a customer generally has the options to switch to another carrier's service. Secondly, the language would preserve the Commission's discretion to exercise the full measure of its regulatory authority to the extent "necessary to implement the requirements of this chapter". Since "this chapter" of the rules does contain a variety of more specific provisions dealing with such matters as tariffs, discrimination, promotion, packaging of services, and prices, the Commission is suggesting that all of the basic provisions of reasonable regulation are covered. This line of argument was embellished upon by the Coalition, which argued that the proposed rule tied the Commission's regulation of CLECs to the detailed rules in the chapter, and provide certainty by setting specific guidelines that reflect and interpret general statutory standards that would otherwise be left to case-by-case interpretation.

32. Opponents of the rule, including Quest and the Minnesota Independent Coalition, argue that the rule, by its terms, attempts to exempt CLECs from the statutory requirements that would otherwise apply to them by virtue of Chapter 237, and that even if it could be shown that there are specific rule provisions which cover all of the existing statutory requirements (a point which they do not agree with), the interaction between this rule and any future statutory changes is confusing at best, and outright illegal at worst. MIC noted that there are several proposals in the legislature to amend Chapter 237, including a Department proposal, and if any of those proposals were adopted that did not clearly relate to the proposed rules, the terms of this subpart would suggest that the new legislation does not apply to CLECs.[15]

33. Both the proponents and opponents of the proposed rule have suggested ways in which the rule could be modified. The Coalition has recommended that the rule could be modified to read as follows:

> The Commission shall, consistent with the requirements of Minnesota Statutes, Chapter 237, exercise its authority over the local services provided by CLECs only to the extent provided for in, or necessary to implement the requirements of, this chapter. [16]

Quest and the MIC have recommended that the rule be amended to read as follows:

> The Commission shall exercise its regulatory authority over the local services provided by CLECs only to the extent provided for in, or necessary to implement the requirements of, Minnesota Statutes, Chapter 237 or this chapter.[17]

34. The ultimate power to make a law rests with the legislature. The legislature may define the scope of an agency's regulatory authority, and an agency may not adopt a rule which expands or limits that scope contrary to the statute. Even where a statute is silent, an agency may not add to its powers, or restrict them, by means of a rule. A commentator has summarized the law in this area as follows (citations omitted):

> [A] rule is invalid if it conflicts with a statute, is inconsistent with the statutory authority pursuant to which it was adopted, is contrary to the legislative intent, limits the agency's appellate jurisdiction without statutory authorization, or adopts a standard beyond the scope of the agency's authority, express or implied by the legislature.[18]

Interpretative rules do not run afoul of the foregoing restrictions, so long as the agency has been granted statutory authority to adopt rules (as the Commission clearly has in this case) and, so long as the interpretative rules do not expand or restrict the agency's authority as established by statute.

It is common for statutes to use general language such as "fair" or "reasonable". It is also common for an agency to adopt a rule which interprets those general words in a more specific way. For example (hypothetically), if the statute said that the rates charged for a local call from a public pay phone must be approved by the Commission and must be "fair", the Commission could adopt a rule which stated that for purposes of that statute, "fair" meant not to exceed 35 cents, or whatever price the Commission decided it wanted to put in the rule. Or, the Commission could adopt a rule which said that for purposes of that statute, "fair" meant a figure not to exceed the result of some formula. But it would not be legal for the Commission to adopt a rule which said that the statute did not apply to certain pay phones in certain kinds of facilities. That kind of a change must be made by the legislature, not by the Commission. If the Commission wants to exempt CLECs from all of Chapter 237, or any other statutory provision, then it must ask the legislature to make that kind of an exemption. The language in the first sentence of subpart 1(A) exceeds the Commission's authority, and cannot be adopted.

35. In order to cure the defect created by the language proposed by the Commission, the sentence must be deleted or modified. Perhaps the easiest modification would be to adopt the language proposed by Quest. Another way to cure the defect would be to go through the individual provisions and recast them so that the general statutory term was interpreted for CLECs in the manner which the Commission desired. The Commission is entitled to formulate classifications and definitions, and apply different interpretations to different types of facilities. In fact, the legislature clearly envisioned this when it adopted the amendments to Section 237.16, directing the Commission to adopt rules. What is interpreted to be "fair" for an ILEC need not be interpreted to be "fair" for a CLEC, and vice versa.

7811/7812.2210, subp. 1(B) – Affiliated CLECs

36. Proposed Rule 7811/7812.2210, subp. 1(B) provides that a CLEC's local service operations inside the service area of its affiliated LEC must be regulated in the same manner as the LEC's local service operations, unless specified otherwise in Chapter 237. On the other hand, when a CLEC is operating outside of the service area of its affiliated LEC, it is not subject to the same manner of regulation as its affiliated LEC. The purpose of the proposed rule is to assure more even competition between CLECs and between CLECs and LECs. One concern is that a LEC would try to evade portions of Chapter 237 by forming a CLEC to operate in its own certificated service area.[19] A related concern is that the ILEC would favor its affiliated CLEC to the detriment of unaffiliated CLECs competing in the same area.[20]

37. Opponents of the proposed rule raise a number of objections to it. Their arguments are all based on the idea that the burdens created by treating an affiliated CLEC are so great that the LEC would choose not to create an affiliated CLEC, or, if one were created, the rule would make it non-competitive. The opponents claim that the proposed rule is not needed, that it would be bad policy, that it would violate federal law, and that it is so vague as to be void for vagueness.

38. It is important to keep in mind that the whole concept of competition in the telephone industry is relatively new, particularly with regard to local service operations. Differentiating between CLECs and ILECs would have been totally incomprehensible to regulators 25 years ago. The major impetus for change came from the Federal Telecommunications Act of 1996, the FCC's Local Competition Order of that same year, and the Minnesota Telecommunications Act of 1995.[21] We do not have decades of experience to draw upon to know whether, in fact, CLECs will be used to evade restrictions on their affiliated LECs. We do not know what amount of anti-competitive behavior would be exhibited without some restrictions on affiliated CLECs dealing with their affiliated LECs. But that does not prevent the Commission from exercising its best judgment about how regulated entities are likely to behave, and adopting rules to prevent harm to the public interest. The requirement in Minn. Stat. § 14.14, subd. 2, that an agency must make an affirmative presentation establishing the need for a proposed rule, does not mean that an agency must wait until some harm has been done. Instead, the law has been interpreted to allow agencies to act to prevent harm before it occurs.

> In the leading Minnesota case on rulemaking, the Minnesota Supreme Court recognized the varying nature of the required factual presentation in noting that it may be necessary for an agency "to make judgments and draw conclusions from 'suspected, but not completely substantiated relationships between facts, from trends among facts, from theoretical projections from imperfect data, from probative preliminary data not certifiable as "fact", and the like.'"[22]

In this case, the Commission concedes that it does not yet have any evidence of LECs discriminating in favor of their affiliated CLECs in their service areas. In

fact, it does not yet have any experience with CLECs doing business in the service areas of their affiliated LECs at all. However, it notes that parties have filed comments expressing concerns about using CLECs to evade ILEC responsibilities, as well as the filing of at least 17 dockets containing allegations of anti-competitive conduct in Quest's service area alone.[23] Finally, the Commission draws on its experience in attempting to facilitate local telephone competition in the "MegaBit" matter. The Administrative Law Judge is acquainted with that matter, and believes that there was certainly a strong appearance of intentional anti-competitive behavior. While US West never conceded fault, it did enter into settlement agreements which required substantial expenditures and substantially altered procedures.[24] Finally, the Commission has expertise which it can bring to bear in evaluating the behavior of companies in this industry. This expertise causes the Administrative Law Judge to give deference to the Commission's projection of likely behavior in the absence of such a rule. The Administrative Law Judge finds that the Commission has made an adequate showing of need and reasonableness for the proposed rule.

39. Opponents next argue that the proposed rule would violate Section 253 of the Federal Telecommunications Act of 1996. Section 253(a) reads, in part:

> No state or local statute or regulation, or other state or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.

However, Section 253(b) provides that a state may impose,

> on a competitively neutral basis . . . requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

Objectors, including MIC, Citizens Telecommunications of Minnesota, and Quest, all suggest that proposed subpart 1(B) does violate Section 253(a) and cannot qualify for the exemption in Section 253(b). They claim that forcing a CLEC to be regulated like a LEC would have the effect of prohibiting it from providing telecommunications service, and the rule would not be saved by Section 253(b) because it is not competitively neutral and not necessary. In support of the first claim, MIC produced two witnesses, both affiliated with ILECs, who stated that they would like to establish CLECs to serve in the same service area as their ILECs, but would not do so if the Commission adopted this proposed rule.[25]

40. The FCC has been faced with a number of challenges to state or local rules based on claims that the state or local regulation or practice prohibited or had the effect of prohibiting the ability of an entity to provide telecommunications service. Some of the cases where the FCC has preempted state or local rules have involved absolute prohibitions against an entity or class of entities serving a particular area.[26] The proposed rule in this case does not

involve an express or implied legal prohibition of service. What is at issue here is a burden, or inconvenience, rather than an outright prohibition. The proposed rule is thus closer to an ordinance which was not preempted in the *California Pay Phone* case.[27] That case involved claims that an ordinance would render certain indoor pay phones impractical and uneconomic, in that they would generate far less revenue than outdoor pay phones. The FCC stated that that was not enough of a burden to preempt the ordinance. The FCC stated that the record would have to demonstrate that the pay phones would generate so little revenue as to *effectively prohibit* an entity from providing pay phone service. That is the same kind of situation that exists with regard to this rule. Clearly, there is not an express prohibition of CLECs providing local service within the territories of their affiliated LECs. Instead, the rule would require such a CLEC to comply with the rules applicable to the LEC (except as expressly exempted by statute). This would be a burden, but it would not be so burdensome as to effectively prohibit the activity. Whether or not a rational businessperson would decide to have a CLEC provide local services within the territory of an affiliated LEC would be a business decision which rational people might decide differently. Even if the same CLEC would find it more profitable to operate outside of the affiliated LEC's territory than it would be to operate inside of the affiliated LEC's territory (a point which the record does not prove one way or the other), some CLECs might choose to proceed, while others would not. That decision would be based on a host of factors involving the cost of establishing the operation, the anticipated revenues, alternative opportunities to deploy capital, etc. Under these circumstances, the Minnesota Commission's proposed rule does not prohibit, or have the effect of prohibiting, the ability of any entity to provide service. Therefore, the proposed rule does not violate Section 253(a) of the Federal Telecommunications Act.

41. Objectors to proposed Rule 7811/7812.2210, subp. 1(B) also argue that the proposed rule is impermissibly vague because it does not define the term "affiliated". When this problem was raised, the Coalition (including Sprint), urged that the definition appearing at Minn. Stat. § 237.65, subd. 1 (which refers to Section 216B.48, subd. 1) be used.[28] Those definitions include a thorough list of mechanisms for controlling a company which essentially boil down to an ownership interest of five percent or more. It is the same definition used for transactions with affiliated companies in the energy field. It was designed for a situation where one company exerted control over another so that their transactions could not be considered arms-length transactions between unrelated parties. That is the same kind of relationship which the Commission seeks to identify in the LEC/CLEC context, and thus it is appropriate to use that definition in these rules.

42. The Administrative Law Judge finds that the absence of a definition of "affiliated" in the proposed rule does make it impermissibly vague. However, this defect may be cured by adopting the statutory definition outlined by the Coalition.

43. In an attempt to blunt some of the criticisms of the Commission's original proposal, and to get at least one of the objecting LEC's support, the Coalition negotiated with Sprint a *de minimis* exemption from the operation of the proposed rule. The Coalition (and Sprint) now advocate that the rule be amended so that a CLEC operating in the territory of an affiliated ILEC would be allowed to operate under the relaxed standards if the fraction of the CLEC's operations in the ILEC territory is ten percent or less of the CLEC's operations in Minnesota, so long as the services being provided inside and outside of the affiliated territory are identical. The Coalition reasoned that the affiliate relationship would not be a significant consideration in the CLEC's provision of services and there should be no concerns that the CLEC is attempting to abuse its affiliate relationship to provide service in the affiliate ILEC territory. The Coalition did not believe that a CLEC could realistically design its services to take advantage of the affiliate relationship if that affiliate relationship only applies to ten percent or less of its services in the state.[29] None of the other ILECs, including MIC, believed that this change solved their underlying problems with the proposed rule. When the matter came to the Commission on November 8, the Commission declined to adopt the proposal. Some of the remarks during the debate suggests that there was a concern that there was no factual basis in the record for picking ten percent, as opposed to some other figure, and thus the Commission could not adopt it. In response to this concern, Sprint referred to the logic put forth by the Coalition noted above, and also pointed out that none of the other ILECs (or anyone else, for that matter) have suggested that the Commission's concerns about affiliated relationships are moot at the ten percent level. Sprint suggests that perhaps ten percent is too low, and the percentage could be raised to an even higher figure without endangering the effectiveness of the proposed rule. But Sprint's main point is that clearly at a ten percent level, the Commission's goals will not be thwarted by a *de minimis* exception.[30]

44. The Administrative Law Judge finds that the record does contain adequate evidence to support the adoption of the ten percent *de minimis* provision. As Judge Beck has noted:

> An important consideration is what type of "facts" must be presented by an agency or others in support of a proposed rule. The choices include trial-type facts, legislative facts, statutory interpretation, articulated policy preferences, and mere common sense. . . . Legislative facts are general facts concerning questions of law, policy, and discretion.
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> Federal case law has generally proceeded along similar lines . . . . The Court of Appeals for the District of Columbia . . . has observed that the absence of firm data may not preclude an agency from adopting rules, since a "quasi-legislative policy judgment," much like that made by Congress, may suffice.[31]

45. The Commission is free to either include the ten percent *de minimis* proposal, or not, as it sees fit. The foregoing Finding provides that the Commission may include the provision if it desires to, but the rule may be adopted without it as well.

46. When the proposed rules were debated before the Commission on November 8, the Commission chose to amend the proposed rule by adding an explicit reference to its variance authority. This addition would go at the very end of subpart 1(B), and would add the words "or varied as in the public interest by the Commission". The Commission does have authority to vary its rules, and standards are set forth in Minn. Rule pt. 7829.3200. That authority, and those standards, would exist regardless of whether or not the proposed language was inserted in the rule or not. The proposed language, therefore, does not really change the legal status of the Commission's authority in this area, but to the extent it provides a convenient reference point for persons reading the rule, there is no reason why it cannot be adopted. The Administrative Law Judge finds that the proposed language adopted by the Commission may be added to the rule.

7811/7812.2210, subp. 16 – Mergers and Acquisitions

47. Before a telecommunications carrier may acquire ownership or control of any line, plant or system, it must first obtain from the Commission a determination that "the present or future convenience and necessity require or will require" the acquisition.[32] In past merger cases, the Commission has developed a number of standards to use in considering them. The SONAR asserts that the proposed rule merely applies these previously used standards to CLECs proposing to merge. It is an attempt to codify the issues the Commission will use to determine whether a proposal meets the "present or future public convenience and necessity" standard.

48. Before the hearings in this matter, Quest raised a concern about the wording of the proposed rule, fearing that it might be interpreted as conflicting with the statute. Quest proposed that the statutory standard be more explicitly referenced in the rule, so that it was clear that the standards set forth in the rule merely interpreted the statutory standard. The Coalition did not agree with Quest's concern, but after negotiations, agreed to support Quest's request for additional language. The proposed language was presented to the Commission on November 8, and the Commission adopted it, with an addition of its own. No party has raised any concerns with the Commission's addition, or the proposed language as adopted by the Commission, and the Administrative Law Judge finds no bar to its adoption as the final rule language. It is not substantially different from the rule as initially proposed, and it may be adopted as finally proposed by the Commission.

7811/7812.2210, subp. 2 – Tariff Filings Required

49. Minn. Stat. §§ 237.07, subd. 1 and 237.74, subd. 1 require the filing of tariffs by telephone companies and telecommunications carriers. The proposed rule generally follows the requirements of the statutes, but makes them more specific.

50. Prior to the hearing, MIC indicated that it agreed with the rule insofar as it went, but thought the rule did not go far enough. MIC believes the rule should not only require the filing of tariffs, but also allow the Commission to correct "unreasonable" terms in the tariffs. MIC noted:

> The Commission should retain the authority to modify unreasonable terms and conditions that affect essential services, even if those terms do not directly violate other specific restrictions within the proposed rules. The Commission's retention of authority in this area is necessary because it is impossible at the time of rulemaking to foresee all potential situations and to provide corresponding prohibitions within these proposed rules. Maintaining the Commission's supervisory discretion and authority would provide a useful "fail-safe" for issues unforeseeable at the time. Such a provision should be added to [the] proposed rule.[33]

In response, the Commission noted:

> The Commission appreciates MIC's concerns, but is not inclined to change the language in the manner MIC suggests. The Commission has proposed these rules with the goal of clarifying and minimizing its role governing non-dominant local carriers such as CLECs. Part of that effort took the form of finding substitute language for broad terms such as "unreasonable". In place of that word, the rule has attempted to catalog the list of conduct that the Commission would find unreasonable.

51. The Administrative Law Judge finds this rule to be an unusual place to be debating the scope of the Commission's powers to declare a tariffed item to be unreasonable. The statutes referenced in the SONAR for this rule talk about filing documents, rather than Commission approval of them. The existing rule (part 7811.2200, subp. 2) talks about filing documents, not about Commission approval. A fundamental step of the rulemaking process is the agency's initial proposal of what rules it wants to adopt. An agency is given very broad discretion (always subject to any specific statutory limitations) to include or exclude various matters from its proposed rules. All that the agency has to do during the rule process is to demonstrate that its proposed rule is needed and reasonable. An objector who desires that the rule go farther than it does, will argue that the rule is unreasonable without the additional material which the objector believes ought to have been added. It is a relatively easy task for the agency to meet its burden, and in most cases a difficult task for the objector to demonstrate the agency has failed to meet its burden. That is the case with this rule. The Commission has chosen to make it a relatively mechanical, nonjudgmental filing requirement. It has justified the reasonableness of its proposal without adding the new concept proposed by MIC. The rule may be adopted as proposed.

7811/7812.2210, subp. 7 – Anti-competitive Combination of Services.

52. The proposed rule would allow the packaging of local telecommunications service with goods and services other than telecommunication services. The rule would require that tariffs contain a general description of the non-telecommunications components of the package, but explicitly denies giving the Commission or the Department regulatory authority over the non-telecommunications services provided by a CLEC.

53. MIC argues that the rule is unreasonable because it does not provide necessary oversight over the anti-competitive bundling of services. Crystal, Global Crossing and Eschelon argue that the rule is unnecessary and unreasonable for other reasons.

54. The example of a CLEC bundling cable television and local telephone service was used during the hearing and in comments, and it provides a useful example of the concepts at issue here. MIC's concern is that a CLEC that has significant market power in cable television might bundle the cable service with local telephone service in such a way that a customer could not get cable television service unless it purchased the telephone service as well. MIC does not suggest that the Commission exert any authority over the offering of the cable television service, but MIC would like the Commission to have the discretion to impose restrictions on the offering of the telephone service when it is bundled with the cable service.[34]

55. The Coalition, in response, makes essentially two arguments. First of all, it argues that the cable television service lies outside the Commission's jurisdiction and the appropriate remedy for unlawful tying is the anti-trust laws. The Coalition also points out that another subpart of this rule (subpart 8D) does allow the Commission to order a CLEC to change a pricing practice if the pricing practice "will impede the development of fair and reasonable competition".

56. The Commission chose not to make any changes to its proposed rule as a result of MIC's objections. It noted that the rules do prevent exploiting market power in the telecommunications market, but do attempt to prevent exploiting market power in the non-telecommunications market. The Commission believes that this is an appropriate line to draw, and the Administrative Law Judge concludes that the Commission has demonstrated it to be a reasonable one. The Commission is not acting out of ignorance, but rather out of weighing the pros and cons of its position. It is entitled to make the policy choices which it has made, and the Administrative Law Judge cannot interfere with them.

57. Crystal Communications, doing business as Hickory Tech, objected to the requirement that a tariff contain a "general description of the non-telecommunications components of the package".[35] The Commission had justified this requirement as necessary to assist regulators in responding to consumer complaints or inquiries regarding packaged service offerings, and to assist in discrimination complaints.[36] The objectors argued that this requirement

adds regulatory costs to the provision of entirely unregulated services, and all that the public gets in return is a "general description", which the objectors do not believe is going to accomplish the goal of helping to answer complaints. In response, the Commission stated that "on the basis of years of experience dealing with tariffs", it believed that the rule would help agencies know what kind of offers are being made and would aid in the investigation of discrimination complaints. The Administrative Law Judge accepts this rationale. Experience is the best indicator of whether or not such filings will be worthwhile, and if experience with similar offerings has shown them to be helpful, then the Commission can require it in this situation as well.

7811/7812.2210, subp. 8 – Prices

58. The Commission has proposed a pricing rule which attempts to balance the Commission's role in protecting the public with the Commission's role in encouraging competition. The proposed rule specifies a number of situations where the Commission may order a CLEC to change a price or pricing practice, but otherwise provides that the CLEC's local services are not subject to any rate or price regulation. MIC is particularly concerned about the absence in the rule of any explicit prohibitions against long-term pricing below cost. MIC believes the Commission should have authority to prevent the low-cost pricing for periods longer than a 90-day promotional period. In response, the Commission points to proposed Rule .2210, subp. 8(C), which allows the Commission to order a CLEC to change a price or pricing practice if the practice "will impede the development of fair and reasonable competition", as well as proposed Rule .2210, subp. 8(E), which allows the same action if the Commission finds that there will be "substantial customer harm". The Administrative Law Judge notes that Minn. Stat. § 237.74, subd. 4 provides that telecommunications carriers (which include CLECs) are not subject to "rate or rate of return regulation" and neither the Commission nor the Department may investigate any matter relating to their "costs, rates or rate of return" with limited exceptions relating to discriminatory rates. The Administrative Law Judge finds that the Commission has justified the reasonableness of its rule without the additional material requested by MIC.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

1. That the Minnesota Public Utilities Commission gave proper notice of the hearing in this matter.

2. That the Minnesota Public Utilities Commission has fulfilled the procedural requirements of Minn. Stat. §§ 14.14, subds. 1, 1a, 1b and 14.14, subds. 2 and 2a, and all other procedural requirements of law or rule.

3. That the Minnesota Public Utilities Commission has demonstrated its statutory authority to adopt the proposed rules and has fulfilled all other substantive requirements of law or rule within the meaning of Minn. Stat. §§ 14.05, subd. 1, 14.15, subd. 3 and 14.50 (i) and (ii), except as noted at Findings 34 and 42.

4. That the Minnesota Public Utilities Commission has documented the need for and reasonableness of its proposed rules with an affirmative presentation of facts in the record within the meaning of Minn. Stat. §§ 14.14, subd. 2 and 14.50 (iii).

5. That the amendments and additions to the proposed rules which were suggested by the MPUC after publication of the proposed rules in the State Register do not result in rules which are substantially different from the proposed rules as published in the State Register within the meaning of Minn. Stat. §§ 14.05, subd. 2 and 14.15, subd. 3.

6. That the Administrative Law Judge has suggested action to correct the defects cited in Conclusion 3 as noted at Findings 35 and 42.

7. That due to Conclusion 3, this Report has been submitted to the Chief Administrative Law Judge for his approval pursuant to Minn. Stat. § 14.15, subd. 3 or 4.

8. That any Findings which might properly be termed Conclusions and any Conclusions which might properly be termed Findings are hereby adopted as such.

9. That a finding or conclusion of need and reasonableness in regard to any particular rule subsection does not preclude and should not discourage the Commission from further modification of the proposed rules based upon an examination of the public comments, provided that the rule finally adopted is based upon facts appearing in this rule hearing record.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

IT IS HEREBY RECOMMENDED: that the proposed rules be adopted except where specifically otherwise noted above.

Dated this _____ day of December, 2000.

ALLAN W. KLEIN
Administrative Law Judge

Reported: Janet Shaddix Elling, Shaddix and Associates

[1] Minn. Stat. § 14.14, subd. 2, and Minn. Rule 1400.2100.

[2] Manufactured Housing Institute v. Pettersen, 347 N.W.2d 238, 244 (Minn. 1984); Mammenga v. Department of Human Services, 442 N.W.2d 786 (Minn. 1989).

[3] In re Hanson, 275 N.W.2d 790 (Minn. 1978); Hurley v. Chaffee, 231 Minn. 362, 367, 43 N.W.2d 281, 284 (1950).

[4] Greenhill v. Bailey, 519 F.2d 5, 10 (8th Cir. 1975).

[5] Mammenga v. Department of Human Services, 442 N.W.2d 786, 789-90 (Minn. 1989); Broen Memorial Home v. Minnesota Department of Human Services, 364 N.W.2d 436, 444 (Minn. Ct. App. 1985).

[6] Manufactured Housing Institute, supra, 347 N.W.2d at 244.

[7] Federal Security Administrator v. Quaker Oats Company, 318 U.S. 2, 233 (1943).

[8] Minn. Rule 1400.2100.

[9] Minn. Stat. § 14.15, subd. 3.

[10] Minn. Stat. § 14.05, subd. 2.

[11] SONAR, Ex. 94, at pp. 23-25.

[12] Transcript, Vol. 2, pp. 82-83.

[13] The Coalition consisted of the Department of Commerce, Office of the Attorney General, the Association of Communications Enterprises, AT&T, the Competitive Telecommunications Association, Eschelon Telecom of Minnesota, Global Crossing, Hickory Tech, McLeod USA, MCI-Worldcom, Seren Innovations, and Sprint. While the Coalition generally agreed on all matters, there were occasional disagreements when one member could not agree with all positions advocated by the group. Unless specifically noted, it can be assumed that statements attributed to the Coalition in this Report are joined in by all members.

[14] Coalition Initial Comments, at p. 11.

[15] See Initial Comments of Minnesota Independent Coalition, at p. 22.

[16] Coaltion Reply Comments, at p. 4.

[17] Initial Comments of MIC, at p. 26.

[18] Beck, Minnesota Administrative Procedure, 2d Edition, Minneapolis (1998).

[19] SONAR, p. 9.

[20] Commission Initial Post-Hearing Comments, p. 6.

[21] See generally, SONAR at pp. 1-4.
[22] Beck, op. cit. at p. 343, quoting from Manufactured Housing Institute, supra.

[23] Commission Initial Comments, at pp. 6-7.

[24] Id. at pp. 9-10.
[25] Transcript, Vol. 2, at pp. 22-39, and Affidavit of James Costello attached to MIC Initial Comments. Similar sentiments were expressed by Charles A. Hoffman on behalf of Citizens Telecommunications Company of Minnesota.

[26] *See*, for example, Matter of Classic Telephone, Inc., 11 FCC Rcd. 13,082 (1996) and New England Public Communications Council Petition for Preemption Pursuant to Section 253, Memorandum Opinion and Order, FCC 96-470 (1996), *recon*. denied, FCC 97-153 (1997).

[27] In the Matter of California Pay Phone Association Petition for Preemption of Ordinance No. 576 NS of the City of Huntington Park, Memorandum Opinion and Order 12 FCC Rcd. 14,191 (1997).
[28] Coalition Initial Comment, at pp. 7-8.
[29] Initial Comments of Coalition, dated November 3, at p. 8.

[30] Reply Comments of Sprint Communications Company, dated November 13, at pp. 3-5.
[31] Beck, *supra*, citing *National Resources Defense Council v. SEC*, 606 F.2d 1031, 1059 (D.C. Cir. 1979).

[32] Minn. Stat. § 237.74, subd. 12. *See also*, Section 237.23.
[33] Ex. 98, MIC Comments of September 20, 2000, at pp. 13-14.
[34] MIC Comments of September 20, 2000, at pp. 14-15.
[35] Ex. 81, Comments Dated February 15, 2000 and Transcript, Vol. 2, at p. 132-33.
[36] SONAR, at p. 15.